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In the Supreme Court of the United States

No. _____

October Term, 1972

THE DETROIT BANK & TRUST COMPANY,
Executor of The Estate of Fred W. Ritter,
Deceased,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit

Petitioner respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the District Court (Appendix A, *infra*, pp. 15-20) is reported at 27 A.F.T.R. 2d 71-1838. The opinion of the Court of Appeals (Appendix B, *infra*, pp. 21-30), reversing (and remanding) the District Court, is reported at ..... F.2d ....., 30 A.F.T.R. 2d ....., ¶147,696.

JURISDICTION

The judgment of the Court of Appeals was entered on September 1, 1972 (Appendix C, *infra*, p. 31). A timely filed petition for rehearing was denied by the Court of Appeals on October 16, 1972 (Appendix D, *infra*, p. 33). A motion for stay of mandate, pending the filing of this petition for certiorari, was granted by the Court of Appeals on November 7, 1972 (Appendix E, *infra*, p. 34). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the insurance *proceeds* of an ordinary, annually renewable life insurance policy upon decedent's life, which was purchased and owned by an irrevocable inter vivos trust, created and funded by the decedent, are thus "transferred" by the decedent to the trust within the meaning of Section 2035 of the Internal Revenue Code and, therefore, includible in his taxable estate, even though not otherwise includible under Section 2042, the provisions relating specifically to insurance *proceeds*.

STATUTES INVOLVED

The pertinent provisions of Section 2035 and 2042 of the Internal Revenue Code of 1954 are set forth in Appendix F, *infra*, pp. 35-36.

REGULATIONS INVOLVED

Treas. Regs. 20.2042-1(a)(2):

> "(2) Proceeds of life insurance which are not includible in the gross estate under section 2042 may, depending upon the facts of the particular case, be includible under some other section of part III of subchapter A of chapter 11. For example, if the decedent possessed incidents of ownership in an insurance policy on his life but gratuitously transferred all rights in the policy in contemplation of death, the proceeds would be includible under section 2035 . . ."

STATEMENT

On April 4, 1964 the decedent entered into an irrevocable trust agreement with The Detroit Bank & Trust Company (trustee) and transferred to it, as original corpus, $9,600 in cash. Pursuant to its express authority, the trustee obtained an ordinary, annually renewable, life insurance policy upon the decedent's life and paid an initial premium of $9,552. On October 6, 1964 the decedent died suddenly of an acute coronary occlusion.

The full proceeds of the policy of $100,000 were collected by the trustee and thereafter held or distributed to or for the benefit of the decedent's daughter and son, respectively. Such proceeds were not included as taxable in the decedent's Federal estate tax return. Upon examination thereof the Commissioner of Internal Revenue determined a deficiency on the grounds that, in effect, the proceeds of the policy were "transferred" by the

decedent in "contemplation of death" within the meaning of Section 2035 of the Internal Revenue Code. The estate of the decedent paid such deficiency, filed a timely claim for refund, and then instituted this suit under 28 U.S.C. Section 1346(a)(1).

A motion for summary judgment was filed in the District Court, conceding for the purpose of the motion only, that the $9,600 was transferred in contemplation of death. The District Court decided that the decedent did not make a "transfer" of the $100,000 of *proceeds* within the meaning of Section 2035 and accordingly granted the motion for summary judgment.

On appeal the Court of Appeals reversed the District Court and held that, on the facts as conceded for the motion for summary judgment, the entire *proceeds* paid to the trustee were taxable and remanded the case to the District Court for further proceedings, not inconsistent with its opinion.

The taxpayer filed a timely petition for rehearing with the Court of Appeals, which was denied. This petition suggested that any rehearing be held *en banc* (Order at Appendix D, *infra*, p. 33).

Within seven days of the denial of the petition for rehearing the taxpayer filed a motion to stay the mandate with the Court of Appeals, which motion was granted (Appendix E, *infra*, p. 34).

REASONS FOR GRANTING THE WRIT

The decision below is (1) in conflict with a decision of another court of appeals; (2) the question involved is of such importance that it should be (but has not yet been) resolved by this Court; (3) the court below has decided a question of Federal tax law in conflict with applicable decisions of this Court; and finally (4) the decision of the court below raises the issue whether resolution of the problem, if one exists, is solely within the purview of Congress. We outline these points as follows:

1. Conflict between two different courts of appeals.

The decision of the Sixth Circuit is in conflict with that of the Fifth Circuit in *First National Bank of Midland, Texas v. United States,* 423 F.2d 1286 (C.A. 5, 1970).

The decision below did not directly discuss the *Midland* case, *supra,* but relied entirely upon *Bel, et al. v. United States,* 452 F.2d 683 (C.A. 5, 1971), cert. denied, ... U.S. ....., 92 S. Ct. 1770 (1972).

That the instant case is in conflict with *Midland* can be easily demonstrated. The *Bel* case in a footnote at 452 F.2d at p. 690 states that the Tax Court decision in *Estate of Coleman v. Commissioner,* 52 T.C. 921 (1969) is essentially identical to the *Midland* case, *supra,* and then further concludes that the entire rationale of *Coleman* is wrong (452 F.2d at p. 690 at Par. 13).

The *Bel* decision first distinguished both *Coleman* and *Midland* upon the facts but, alternatively, decided that the so-called "diverted asset" theory relied upon by *Coleman*

and *Midland* was incorrect. The Court of Appeals in the instant case also rejected the "diverted asset" theory.*

The conflict between the Fifth Circuit cases of *Bel* and *Midland* was advanced as a principal ground of the petition for certiorari in *Bel*. In denying certiorari in that case this Court may well have determined that conflict within a circuit, between panels of the same court of appeals, is more appropriately left to that court to determine; see *Wisniewski v. United States*, 353 U.S. 901 (1957). In *Bel* the taxpayers might have petitioned the Fifth Circuit for rehearing *en banc* but, as we are informed, they did not do so.

In the instant case the conflict is between the Fifth and Sixth Circuits. Although hearing *en banc* was here suggested to the Court of Appeals in connection with our motion for rehearing, that procedure would not have reached the essential inter-circuit conflict, which can only be resolved by this Court.

2. Question of extreme importance which has not yet been but which should be resolved by this Court.

No litigation in this area existed between the time of enactment of Section 2042 of the Internal Revenue Code of 1954 (Appendix F, pp. 35-36) and 1968 (it being recalled that the decedent herein died in 1964). But since 1968 such litigation has proliferated at an ever increasing rate. The trial court cases decided in favor of the taxpayers are as follows: *Gorman v. United States*, 288 F. Supp. 225 (E.D. Mich. 1968); *Nance v. United States*, 68-1 U.S.T.C.

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* Such theory was originally adopted by this Court in *Milliken v. United States*, 283 U.S. 15 (1931) discussed, *infra*, at p. 8.

87403 (D.C. Ariz. 1968); *Estate of Inez Coleman v. Commissioner*, 52 T.C. 921 (1969) (decision *en banc* by all sixteen judges with four dissents; one majority and three separate dissenting opinions); *Mercantile Trust Co. National Association v. United States*, 312 F. Supp. 108 (E.D. Mo. 1970); *Bel v. United States*, 310 F. Supp. 1189 (W.D. La. 1970); and, of course, this case, reported at 27 A.F.T.R. 2d 71-1838 (Appendix A, *infra*, pp. 15-20).

The trial court cases decided in favor of the government are as follows: *First National Bank of Midland, Texas v. United States*, 23 A.F.T.R. 2d 69-1806 (W.D. Tex. 1968), and *The First National Bank of Oregon v. United States*, ... F. Supp. ....., '72 CCH Fed. Est. & Gift Tax Reports ¶12,884 (D.C. Ore. Sept. 8, 1972).

Of the cases cited, *supra*, the *Midland* case was reversed by the Fifth Circuit in favor of the taxpayer, whereas the *Bel* case and the instant case (with one significant dissent) were reversed in favor of the government.

We have been informed that the taxpayer in the *The First National Bank of Oregon* case has filed notice of appeal to the Ninth Circuit and intends to prosecute such appeal.

Until this Court provides a definitive solution, responsible government officials and private counsel will, as a practical matter, be unable to advise their respective clients how to resolve the problem such as herein raised, short of litigation.*

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* Although the government has issued two revenue rulings in this area; i.e. Rev. Rul. 67-463, 1967-2 Cum. Bull. 327 and Rev. Rul. 71-497, I.R.B. 1971-45, p. 16, which revokes Rev. Rul. 67-463, the litigating posture of the government is not presently that of either ruling but, rather, it is represented by the contentions, accepted in the *Bel* case, *supra*, and by the Court of Appeals in the instant case. Such litigating posture is in conflict with the *Midland* case, *supra*.

3. The court below has decided a question of Federal tax law in conflict with applicable decisions of this Court.

Milliken v. United States, 283 U.S. 15, 22 (1931) held that the purpose of Section 2035 is to put back in the taxable estate that which *would have been there had there been no transfer* in contemplation of death (the so-called "diverted asset" theory referred to above).

On the other hand the clearly stated purpose of Section 2042 is to include in the taxable estate the *proceeds* of insurance policies in which the decedent possessed "incidents of ownership" at death. For many years prior to 1954, the predecessor section of Section 2042 *also* called for inclusion of the proceeds to the extent that the decedent *paid the premiums* on the policies, a test intentionally abandoned by Congress with the enactment of the 1954 Code.

The question here is solely, therefore, what property was "transferred" which, but for such transfer, would have been in the taxable estate at death?

It is the answer given by the court below to this question that violates and misapplies fundamental principles of tax law as exemplified by applicable decisions of this Court. One of these principles is the familiar "substance over form" doctrine as illustrated in *Gregory v. Helvering*, 293 U.S. 465 (1935) and many other cases too numerous to cite. In some cases, where the facts are appropriate, the doctrine is referred to as the "step transaction" or "single scheme" theory. See, for example, *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U.S. 179 (1942).

It is this doctrine (or doctrines) which the government and the court below very subtly misapply (Appendix B, *infra*, pp. 21-30). At the same time there was a

complete failure by the court below to give full force and effect to the principles of other decisions of this Court. For example, it is axiomatic in tax law that a taxpayer need not frame his economic transactions in such a way as to result in the greatest amount of tax. Indeed he may by legal means frame them so as to minimize them. *United States v. Isham*, 84 U.S. 496, 506 (1873); *Gregory v. Helvering*, 293 U.S. 465, 469 (1935); *Commissioner v. Tower*, 327 U.S. 280, 288 (1946). As stated in *United States v. Cumberland Public Service Co.*, 338 U.S. 451 (1950) at p. 456:

> "Congress having determined that different tax consequences shall flow from different methods by which the shareholders of a closely held corporation may dispose of corporate property, we accept its mandate. It is for the trial court . . . to determine the factual category in which a particular transaction belongs."

Cf. *Commissioner v. Court Holding Co.*, 324 U.S. 331 (1945). Although *Cumberland* involved minimization of *income tax* by a proper structuring of a transaction, there is no valid reason for applying a different rule for *estate tax* purposes and, specifically, to this case. The decedent *could have* taken out the insurance policy on his own life, then created the trust and then transferred ownership of the policy to the trustee. But the fact is he did not. As determined by Chief Judge Freeman in the District Court, the decedent transferred $9,600 to the trust and this was the only property which was transferred. It would, therefore, have been the only additional property in his estate had the transfer not have been made. Certainly had the transfer *not* have been made $100,000 would not have constituted the amount of "diverted assets."

No matter how complex one can attempt to make this case, when all is said and done the government here is attempting to tax an imaginary transfer. This it cannot do. Nor, may the trust be considered the agent of the decedent in acquiring the insurance policy with himself *as owner* any more than were the shareholders of the *Cumberland Public Service Co.* conduits for the corporation for the sale of the liquidated assets in that case. See 338 U.S. at p. 455.

We have emphasized the *actualities* of the transactions here involved because of the heavy reliance of the government and the court below upon the admitted *dictum* in *Chase National Bank v. United States,* 278 U.S. 327 (1929). That case did not involve the contemplation of death provisions of the law. Rather, it involved the constitutionality of the estate tax as imposed specifically on insurance proceeds. The issue was whether the tax was an unconstitutional, unapportioned, direct tax on property or was a constitutional privilege tax on a transfer of property at death. The Court held the tax constitutional. In the course of so doing it had occasion to discuss the word "transfer."

But what the government overlooks is that the "transfer" the Court was concerned with in the *Chase* case was the *final transfer* of the *insurance proceeds* to the beneficiary by the insurance company. In that situation it is perfectly clear that such a transfer was made by virtue of what might be equated to a third party beneficiary contract, and that for estate tax purposes, at least, this amounted to the transfer of such proceeds at death *from* the decedent.

But it also should be perfectly clear that we are *not here* concerned with any question involving the mechani-

cal delivery (transfer) of the insurance check by the insurance company to the trustee *after* the decedent's death. Instead, we are dealing with an *inter vivos transfer* by the decedent and the subject matter of *that transfer*. As clearly shown above, that "transfer" was $9,600 in cash and was not a transfer of any incidents of ownership in an insurance policy because the decedent never possessed any. The manner in which the government gets around this basic reality is to set up a "straw man" and then knock him down. It "imagines" that the decedent took out the policy as owner and then transferred his incidents of ownership to the trust.

The crucial question, as noted in all of the decided cases, is "what has been transferred?" Was it money—or was it "incidents of ownership" in the policy? The Treasury Regulations require taxation in the latter case. (See Treas. Regs. 20.2042-1(a)(2), *supra* at p. 3). It is submitted that the reason most of the decisions have held for the taxpayer on this issue is that in order to invoke the "substance over form" doctrine in the various factual patterns involved requires that the "payment of the insurance premiums" must, of necessity, be paid by the insured. This is the *core* of the government's position.

Because of this fact, it is further submitted that the courts which have held for the taxpayers on this issue have been reluctant to invoke this doctrine because it is clearly contrary to the intent of Congress as evidenced by its having deliberately discarded the "payment of premiums" test in 1954 when Sec. 2042 was enacted. The sole test under Sec. 2042 is the possession of "incidents of ownership" in the policies at the date of death of the decedent. This is not to say that Sec. 2035 has no application in the insurance area; but it is to say that its application, substantively, as well as literally, is limited to the situation described in Treas. Regs. 20.2042-1(a)(2), *supra,* which requires an

actual transfer in contemplation of death of incidents of ownership in an insurance policy.

The practical conclusion must, therefore, be drawn that the government in *this* case and in the others previously litigated is still *actually* depending upon the "payment of premiums" by the decedent-insured constituting in "substance," although not in form, a "transfer" of the incidents of ownership in a policy. Such a position is in contradiction to the clear intent of Section 2042 of the Code, even considering the cross reference to Sec. 2035 contained in Treas. Regs. 20.2042-1(a)(2), *supra*. If the latter section applies at all it applies to the property actually transferred, to wit, cash, i.e. the "diverted assets" only.

Thus, if the "substance over form" doctrine is properly applied to this case it does no more than result in the conclusion that, for tax purposes, the decedent, rather than the trustee, made the "premium payment," and that the amount of such payment is the measure of the assets diverted from the taxable estate under existing law. To go further than this is to improperly "reinstate" the "premium payment" test abandoned in 1954 by Congress.

The court below has thus decided this case in a way which conflicts with the well established principles of applicable decisions of this Court: *United States v. Isham, supra; Gregory v. Helvering, supra; Commissioner v. Tower, supra; Cumberland Public Service Co., supra,* and, specifically, *Milliken v. United States, supra,* as well as clear and specific Congressional action. Thus, see below:

4. If the proceeds of life insurance in a case such as this are unfairly escaping estate tax it is within the purview of the legislative branch and not the executive or judicial branch to make any changes deemed appropriate.

Under existing statutory provisions, except in a case where actual ownership rights in a policy *at some time owned* by a decedent are transferred in contemplation of death, Section 2035 of the Internal Revenue Code is inapplicable with respect to insurance *proceeds*. See Treas. Regs. 20.2042-1(a)(2), *supra*, at p. 3. The dictum of this Court in the *Chase* case, *supra*, as being determinative of *what* was transferred in this case is inapplicable and the application of the "substance over form" doctrine can only result in the conclusion that the decedent paid, and therefore, "transferred" only the "premium" but not the insurance *proceeds*.

Therefore, if any remedy is needed (and we do not concede that it is), it should be accomplished by the Congress through an appropriate amendment to Section 2042 which deals specifically with insurance *proceeds*.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

JAMES F. KENNEDY, JR.
GERALD P. MORAN
KURT KERSTEN
Counsel for Petitioner

APPENDIX A

Opinion of the District Court

(Dated May 5, 1971)

Civil Action No. 33075
UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN SOUTHERN DIVISION

THE DETROIT BANK & TRUST COMPANY,
Executor of the Estate of Fred W. Ritter, Deceased,
Plaintiff,

-vs-

UNITED STATES OF AMERICA,
Defendant.

OPINION

Plaintiff is the duly appointed Executor of the Estate of Fred W. Ritter, deceased, having been granted letters testamentary on December 15, 1964 by the Probate Court of Monroe County, Michigan. The present action has been instituted pursuant to 28 U.S.C. § 1346(a)(1) for the recovery of internal revenue taxes alleged to have been erroneously assessed on, and collected from, the Ritter estate.

The following facts are admitted by both plaintiff and the defendant United States Government. On April 9, 1964, plaintiff's decedent entered into a Trust Agreement with The Detroit Bank & Trust Company as Trustee. This agreement created an irrevocable trust in which the de-

cedent relinquished the right to alter, amend, revoke or terminate. Under the terms of the Trust, the Trustee was required to obtain and hold insurance on the life of the decedent. All rights, interest and title to the life insurance policy or policies so acquired were to vest immediately in the Trustee. Upon the decedent's death, the trust was to be divided into two equal parts, one to be distributed to the decedent's son, and the other to be held in trust for the benefit of the decedent's daughter.

At the time the trust was created, the decedent transferred $9,600.00 to its corpus to be used in acquiring the insurance on his life. Pursuant to the terms of the trust, the Trustee then used part of the trust corpus to obtain a life insurance policy in the amount of $100,000.00 on the life of the decedent. That policy, numbered 3287319, was issued by Travelers Insurance Company, and an initial premium of $9,552.00 was paid on it by the Trustee.

On October 6, 1964, decedent died. Disclosure was made on the federal estate tax return form of the trust, its terms, and the $100,000.00 Travelers life insurance policy owned by the Trustee. The value of the policy, however, was excluded by the Executor from decedent's gross estate. But after an audit, the Internal Revenue Service found that the life insurance policy proceeds should be included in decedent's gross estate for federal tax purposes. An estate tax deficiency of $28,377.37, resulted from this inclusion of the $100,000.00 life insurance proceeds in decedent's gross estate. The amount of that deficiency, plus a deficiency interest of $3,111.24, was collected by the Detroit District Director of Internal Revenue on November 20, 1967. Plaintiff contends that this assessment and collection of the $28,337.37 tax deficiency, plus the interest of $3,111.24, was erroneous, and asks for the refund of this amount, which totals $31,487.61, as well as for statutory

interest from the date of payment to the Internal Revenue Service.

The case is now before the Court on plaintiff's motion for summary judgment. There is only one material fact in dispute between plaintiff and defendant, and that fact involves the question of the decedent's intent at the time he transferred to the trust corpus the $9,600.00 used to pay the insurance premium. The United States maintains that this transfer was made in contemplation of death, while plaintiff contends that it was not so made. Nevertheless, for the purposes of its motion for summary judgment, plaintiff asks the court to assume that defendant is correct on this fact and that the decedent's transfer of the $9,600.00 to the irrevocable trust was in contemplation of his death.

The United States argues that since decedent, within three years of his death and in contemplation of death, transferred the $9,600.00 to the irrevocable trust for payment of the initial premium on the Travelers insurance policy, the value of this policy at the date of decedent's death is includable in his estate for tax purposes under 26 U.S.C. § 2035 and Treasury Regulation Section 20.2035-1. Those sections provide:

> SEC. 2035 [as amended by Sec. 18(a)(2)(C), Revenue Act of 1962, P. L. 87-834, 76 Stat. 960].
>
> *Transactions in Contemplation of Death.*
>
> (a) *General Rule*—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, in contemplation of his death.

(b) *Application of General Rule*—If the decedent within a period of 3 years ending with the date of his death (except in case of a bona fide sale for an adequate and full consideration in money or money's worth) transferred an interest in property, relinquished a power, or exercised or released a general power of appointment, such transfer, relinquishment, exercise, or release shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this section and sections 2038 and 2041 (relating to revocable transfers and powers of appointment); but no such transfer, relinquishment, exercise, or release made before such 3-year period shall be treated as having been made in contemplation of death.

§ 20.2035-1 *Transactions in contemplation of death.*

(e) *Valuation.* The value of an interest in transferred property includible in a decedent's gross estate under this section is the value of the interest as of the applicable valuation date. In this connection, see sections 2031, 2032, and the regulations thereunder. However, if the transferee has made improvements or additions to the property, any resulting enhancement in the value of the property is not considered in ascertaining the value of the gross estate. Similarly, neither income received subsequent to the transfer nor property purchased with such income is considered.

Plaintiff, on the other hand, argues that when a decedent pays premiums on a life insurance policy taken out on his own life, but in which he has no incidents of ownership, the only amount includable in his estate under 26 U.S.C. § 2035 is the amount transferred to pay the

premiums, if this transfer was made within three years of his death and in contemplation of his death. We believe that plaintiff's construction of 26 U.S.C. § 2035 is the correct one. Indeed, this position has now been adopted by the Fifth Circuit Court of Appeals in the *First National Bank of Midland v. U. S.*, 70-1 CCH USTC ¶12666 (5th Cir. 3-23-70); by the United States District Court for the Eastern District of Missouri, *Mercantile Trust Company v. U. S.*, 70-1 CCH USTC ¶12678 (E. D. Mo. April 8, 1970); and by the Tax Court in the *Estate of Inez Coleman*, 52 T.C. 99 (Sept. 9, 1969). More importantly, Judge Kaess of our own Court considered this question in a comprehensive decision rendered in 1968 and he, too, held for the taxpayer, after rejecting the identical legal arguments the Government now urges us to accept. *Gorman v. U. S.*, 288 F. Supp. 225 (E. D. Mich. 1968).

Here, it is undisputed that the decedent never had any interest in the Travelers life insurance policy but, instead, had transferred to an irrevocable trust the sum of $9,600.00 to pay the initial premium on such a policy. At the time the Trustee acquired this life insurance policy, with the $9,552.00 paid out of the trust corpus, it acquired all interests in that policy. Thus, in line with the reasoning and holdings of the above cited decisions, we find that the proceeds of the Travelers life insurance policy acquired by the Trustee with the funds supplied by decedent's transfer to the trust corpus are not includable in decedent's gross estate for federal tax purposes. Nevertheless, if decedent's transfer of the $9,600.00 to the trust corpus for acquisition of the life insurance policy was made in contemplation of death, then this sum is includable in decedent's estate under 26 U.S.C. § 2035, since this transfer was in the nature of a gift depleting decedent's estate within three years of death.

Hence, plaintiff is, on its present summary judgment motion, entitled to a refund on so much of the deficiency tax and interest attributable to the inclusion of the $100,000.00 life insurance policy in decedent's estate less the $9,600.00 transferred by decedent to the trust corpus for payment of premiums on that policy. Whether plaintiff is similarly entitled to a refund of so much of the estate tax attributable to the $9,600.00 transfer depends upon whether this transfer, made within three years of death, was in contemplation of death. Plaintiff, however has stipulated that it will waive its right to any additional tax refund attributable to the $9,600.00 transferred to the irrevocable trust, upon receiving a judgment for the tax and interest attributable to the $90,400.00. ($100,000.00 – $9,600.00 = $90,400.00). Therefore, in now granting plaintiff's motion for summary judgment, we dispose of the entire lawsuit.

An appropriate order may be submitted.

/s/ RALPH M. FREEMAN
Chief Judge

Dated: Detroit, Michigan
May 5th, 1971.

APPENDIX B

Opinion of the Court of Appeals

(Decided and Filed September 1, 1972)

No. 71-1790

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

THE DETROIT BANK & TRUST COMPANY,
Executor of the Estate of Fred W. Ritter, Deceased,
Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Eastern District of Michigan, Southern Division.

Before: EDWARDS and PECK, Circuit Judges, and McALLISTER, Senior Circuit Judge.

EDWARDS, Circuit Judge. This appeal concerns taxation of the estate of Fred W. Ritter. On April 9, 1964, being then in apparent good health, he entered into a trust agreement with The Detroit Bank and Trust Company as trustee, by which he transferred $9,600 to a trust to acquire $100,000 of insurance on his life, with the beneficiaries of the insurance to be his children. The trust was irrevocable and nominally beyond his control, but it provided for him to continue to make contributions to the

trust for the payment of life insurance premiums, and its terms confined the trustees to expending the funds solely for the described purpose. Ritter died about six months later on October 6, 1964.

For purposes of this appeal the parties have stipulated that the money paid to the trust shall be presumed to have been given in contemplation of death, under Section 2035 of the Internal Revenue Code of 1954, 26 U.S.C. § 2035 (1954). The dispute, however, concerns whether the value, for purposes of estate taxation, should be determined by the value of the payment made to the trust or by the value of the insurance proceeds actually paid to the trustee on the event of Ritter's death?

The District Judge heard this case on stipulated facts and on plaintiff's motion for summary judgment. Following an opinion in the United States District Court for the Eastern District of Michigan, *Gorman v. United States*, 288 F. Supp. 225 (E.D. Mich. 1968), he held that plaintiff's motion for summary judgment should be granted so as to effect taxation on decedent's estate only to the extent of the $9,600 transferred to the irrevocable trust.

The government relies for reversal of this judgment primarily upon Section 2035 of the Internal Revenue Code of 1954, plus the related regulation:

> **§ 2035. Transactions in contemplation of death**
>
> **(a) General rule.**—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, in contemplation of his death.

(b) Application of general rule.—If the decedent within a period of 3 years ending with the date of his death (except in a case of a bona fide sale for an adequate and full consideration in money or money's worth) transferred an interest in property, relinquished a power, or exercised or released a general power of appointment, such transfer, relinquishment, exercise, or release shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this section and sections 2038 and 2041 (relating to revocable transfers and powers of appointment); but no such transfer, relinquishment, exercise, or release made before such 3-year period shall be treated as having been made in contemplation of death. Aug. 16, 1954, c. 736, 68A Stat. 381; Oct. 16, 1962, Pub.L. 87-834, § 18(a)(2)(C), 76 Stat. 1052. 26 U.S.C. § 2035(a), (b) (1954), *as amended.*

(e) *Valuation.* The value of an interest in transferred property includible in a decedent's gross estate under this section is the value of the interest as of the applicable valuation date. In this connection, see sections 2031, 2032 and the regulations thereunder. However, if the transferee has made improvements or additions to the property, any resulting enhancement in the value of the property is not considered in ascertaining the value of the gross estate. Similarly, neither income received subsequent to the transfer nor property purchased with such income is considered. 26 C.F.R. § 20.235-1(e) (1972).

Both sides also argue the meaning and applicability of Section 2042 of the Internal Revenue Code of 1954:

§ 2042. Proceeds of life insurance

The value of the gross estate shall include the value of all property—

(1) Receivable by the executor.—To the extent of the amount receivable by the executor as insurance under policies on the life of the decedent.

(2) Receivable by other beneficiaries.—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. * * * 26 U.S.C. § 2042(1), (2) (1954).

This case again presents the age-old argument in tax cases of form versus substance. Appellee executor claims that decedent never owned the insurance policy and, hence, never transferred it. The executor also claims that the only transfer was the payment by decedent of $9,600 to the trustee and that $9,600 is the greatest sum which possibly can be subject to tax under § 2035.

The government asks us to look through form to substance. It asserts that decedent transferred "insurance protection" as surely as if he had bought the policy and then assigned it to the trustee. The government concedes that decedent did not retain any "incidents of ownership," within the meaning of § 2042, but asks us to hold that "the trustee was in substance and reality acting as the decedent's agent in purchasing the policy."

The District Judge relied upon several cases dealing with the same issue: *Mercantile Trust Co. v. United States*, 70-1 CCH USTC ¶12678 (E.D. Mo. April 8, 1970);

Estate of Inez Coleman, 52 T.C. 99 (Sept. 9, 1969); *Gorman v. United States,* 288 F. Supp. 225 (E.D. Mich. 1968). He held:

> Here, it is undisputed that the decedent never had any interest in the Travelers life insurance policy but, instead, had transferred to an irrevocable trust the sum of $9,600.00 to pay the initial premium on such a policy. At the time the Trustee acquired this life insurance policy, with the $9,552.00 paid out of the trust corpus, it acquired all interests in that policy. Thus, in line with the reasoning and holdings of the above cited decisions, we find that the proceeds of the Travelers life insurance policy acquired by the Trustee with the funds supplied by decedent's transfer to the trust corpus are not includable in decedent's gross estate for federal tax purposes. Nevertheless, if decedent's transfer of the $9,600.00 to the trust corpus for acquisition of the life insurance policy was made in contemplation of death, then this sum is includable in decedent's estate under 26 U.S.C. § 2035, since this transfer was in the nature of a gift depleting decedent's estate within three years of death.

Subsequent to decision of this case, the government has issued a revenue ruling, Rev. Rul. 71-497, 1971 INT. REV. BULL. No. 45, at 16, reiterating the government's position as stated above. Also subsequent to decision by the District Judge, the Fifth Circuit handed down a well reasoned opinion which arrives at the result sought herein by appellant United States of America. *Bel v. United States,* 452 F.2d 683 (5th Cir. 1971), *cert. denied,* ____ U.S. ____ (1972) (40 U.S.L.W. 3542 (U.S. May 15, 1972).

In *Bel* where the decedent employed a trust essentially identical to that at issue here, the Fifth Circuit held the tax applied. It said:

We recognize, of course, that John Bel never formally possessed any of the incidents of ownership in the accidental death policy. As noted above, however, we conclude that section 2042 and the incidents-of-ownership test are totally irrelevant to a proper application of section 2035. We think our focus should be on the control beam of the word "transfer." The decedent, and the decedent alone, beamed the accidental death policy at his children, for by paying the premium he designated ownership of the policy and created in his children all of the contractual rights to the insurance benefits. These were acts of transfer. The policy was not procured and ownership designated and designed by some goblin or hovering spirit. Without John Bel's conception, guidance and payment, the proceeds of the policy in the context of this case would not have been the children's. His actions were not ethereally, spiritually, or occulty actuated. Rather, they constituted worldly acts which by any other name come out as a "transfer." Had the decedent, within three years of his death, procured the policy in his own name and immediately thereafter assigned all ownership rights to his children, there is no question but that the policy proceeds would have been included in his estate. In our opinion the decedent's mode of execution is functionally indistinguishable. Therefore, we hold that the action of the decedent constituted a "transfer" of the accidental death policy within the meaning of section 2035, and that the district court erred in failing to include John Bel's community share of the proceed value of the policy in his gross estate. *Bel v. United States, supra* at 691-92.

The Fifth Circuit in *Bel* relied heavily upon language employed in Justice Stone's opinion for the Supreme Court in *Chase National Bank v. United States*, 278 U.S. 327 (1929).

In the *Chase National Bank* case the Supreme Court upheld the constitutionality of the estate tax (§§ 401 and 402 (f) of the INT. REV. ACT of 1921, 42 Stat. 277, 278). It concluded that the tax was on a decedent's privilege of transferring property at his death. It rejected the argument that the transfer to the beneficiaries of the proceeds of an insurance policy came not from the deceased but from the insurer. The Supreme Court said:

> Obviously, the word *"transfer"* in the statute, or the privilege which may constitutionally be taxed, cannot be taken in such a restricted sense as to refer only to the passing of particular items of property *directly from the decedent to the transferee. It must, we think, at least include the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another. Sec. 402* (c) taxes transfers made in contemplation of death. It would not, we assume, be seriously argued that its provisions could be evaded by the purchase by a decedent from a third person of property, a savings bank book for example, and its delivery by the seller directly to the intended beneficiary on the purchaser's death, or that the measure of the tax would be the cost and not the value or proceeds at the time of death. *Chase National Bank v. United States, supra* at 337. (Emphasis added.)

We recognize that the language above from *Chase* was employed to apply to facts which are not identical with those with which we deal here. The decedent in

Chase transferred a policy which he owned. But the opinion does serve directly to establish the principle that the event taxed was the transfer of property *at death.* And the case illustrates the strong inclination of the Court to uphold the congressional intent as opposed to a technical interpretation.

This same inclination we find mirrored in the language of two other leading cases dealing with the federal estate tax provision for taxing gifts in contemplation of death. In *Milliken v. United States,* 283 U.S. 15 (1931), the Supreme Court upheld the constitutionality of taxation of gifts in contemplation of death by valuation as of the date of death. It said in part:

> It is sufficient for present purposes, that such gifts are motivated by the same considerations as lead to testamentary dispositions of property, and made as substitutes for such dispositions without awaiting death, when transfers by will or inheritance become effective. Underlying the present statute is the policy of taxing such gifts equally with testamentary dispositions, for which they may be substituted, and the prevention of the evasion of estate taxes by gifts made before, but in contemplation of, death. It is thus an enactment in aid of, and an integral part of, the legislative scheme of taxation of transfers at death. *Milliken v. United States, supra* at 23.

And in *United States v. Wells,* 283 U.S. 102 (1931), the Court extended the meaning of gifts "in contemplation of death" well beyond the concept of gifts *causa mortis.* It said:

> The statutory description embraces gifts *inter vivos,* despite the fact that they are fully executed, are irrevocable and indefeasible. The quality which

brings the transfer within the statute is indicated by the context and manifest purpose. Transfers in contemplation of death are included within the same category, for the purpose of taxation, with transfers intended to take effect at or after the death of the transferor. *The dominant purpose is to reach substitutes for testamentary dispositions and thus to prevent the evasion of the estate tax. Nichols v. Coolidge,* 274 U.S. 531, 542; *Milliken v. United States, ante,* p. 15. *United States v. Wells, supra* at 116-117. (Emphasis added.)

We believe that what this appeal presents is still another method of evading a portion of the federal estate tax. At oral argument counsel for appellee bank did not seriously dispute this characterization, but contended that the device employed made use of an existing loophole in the federal tax statutes and that his client should be allowed full benefit of that loophole until, when, as, and if Congress elected to close it.

We do not deny the force of this argument or dispute the proposition that the District Court arrived at a result which can easily be defended by technical construction of the statute. Yet it appears to us that the congressional purpose was clearly to sweep into the estate tax gifts of insurance made in contemplation of death and to value such gifts in terms of the transfer of the proceeds at death rather than at the purchase or premium cost.

If the dominant purpose of Section 2035 is "to reach substitutes for testamentary disposition and thus to prevent evasion of the estate tax" (*United States v. Wells, supra* at 117), we feel justified in holding that the trustee in this case was an agent for purchase of the insurance and that the trust device was a "substitute for testamentary disposition."

The judgment of the District Court is reversed and the case is remanded for further proceedings consistent with this opinion.

McAllister, Senior Circuit Judge, dissenting. I respectfully dissent from the opinion of the Court and am of the view that the judgment of the District Court should be affirmed for the reasons set forth in Judge Freeman's opinion.

APPENDIX C

Judgment of the Court of Appeals

(Filed September 1, 1972)

No. 71-1790

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

THE DETROIT BANK & TRUST COMPANY,
Executor of the estate of Fred W. Ritter,
deceased,
Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Before: EDWARDS and PECK, Circuit Judges, and McALISTER, Senior Circuit Judge

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JUDGMENT

APPEAL from the United States District Court for the Eastern District of Michigan.

THIS CAUSE came on to be heard on the record from the United States District Court for the Eastern District of Michigan and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby reversed and the cause is remanded for further proceedings consistent with the opinion.

No costs awarded. Rule 39(b).

Entered by order of the Court.

/s/ James A. Higgins
Clerk

APPENDIX D

Order of the Court of Appeals Denying Rehearing

(Filed October 16, 1972)

No. 71-1790

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

THE DETROIT BANK & TRUST COMPANY, Executor of the Estate of Fred W. Ritter, Deceased,
Plaintiff-Appellee,

vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

ORDER

Before: EDWARDS and PECK, Circuit *Judges*, and McALLISTER, Senior Circuit Judge.

On consideration of the petition for rehearing filed in the above-styled case (no active judge having moved for rehearing in banc),

Said petition is hereby denied.

Entered by order of the Court

/s/ James A. Higgins
Clerk

APPENDIX E

Order of the Court of Appeals Staying Mandate

(Filed November 7, 1972)

No. 71-1790

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

THE DETROIT BANK & TRUST COMPANY, Executor of the Estate of Fred W. Ritter, Deceased,
Plaintiff-Appellee,

vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Before: EDWARDS and PECK, Circuit *Judges*, and McALLISTER, Senior Circuit Judge.

ORDER STAYING MANDATE

ORDERED, That motion to stay mandate herein pending application to the Supreme Court for writ of certiorari is hereby granted and the mandate is stayed for thirty days from this date, provided that, if within such thirty days, the applicant shall file with the Clerk of this Court the certificate of the Clerk of the Supreme Court that the certiorari petition, record, and brief have been filed, the stay shall continue until the final disposition of the case by the Supreme Court. Unless this condition is complied with within such thirty days or any extension thereof made by the Court or any judge thereof, or if the condition is complied with, then upon the filing of copy of an order denying the writ applied for, the mandate shall issue.

Entered by order of the Court.

/s/ James A. Higgins
Clerk

APPENDIX F

Internal Revenue Code of 1954

"§2035. Transactions in contemplation of death

"(a) General rule.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, in contemplation of his death.

"(b) Application of general rule.— If the decedent within a period of 3 years ending with the date of his death (except in case of a bona fide sale for an adequate and full consideration in money or money's worth) transferred an interest in property, relinquished a power, or exercised or released a general power of appointment, such transfer, relinquishment, exercise, or release shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this section and sections 2038 and 2041 (relating to revocable transfers and powers of appointment); but no such transfer, relinquishment, exercise, or release made before such 3-year period shall be treated as having been made in contemplation of death. Aug. 16, 1954, c. 736, 68A Stat. 381; Oct. 16, 1962, Pub.L. 87-834, §18(a)(2)(C), 76 Stat. 1052."

"§2042. Proceeds of life insurance

"The value of the gross estate shall include the value of all property—

"(1) Receivable by the executor.— To the extent of the amount receivable by the executor as insurance under policies on the life of the decedent.

"(2) Receivable by other beneficiaries.—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. For purposes of the preceding sentence, the term 'incident of ownership' includes a reversionary interest (whether arising by the express terms of the policy or other instrument or by operation of law) only if the value of such reversionary interest exceeded 5 percent of the value of the policy immediately before the death of the decedent. As used in this paragraph, the term 'reversionary interest' includes a possibility that the policy, or the proceeds of the policy, may return to the decedent or his estate, or may be subject to a power of disposition by him. The value of a reversionary interest at any time shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, pursuant to regulations prescribed by the Secretary or his delegate. In determining the value of a possibility that the policy or proceeds thereof may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such policy or proceeds may return to the decedent or his estate.

"Aug. 16, 1954, c. 736, 68A Stat. 387."